APPENDIX B

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UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

(18 CFR 2.75)

Before Commissioners: John N. Nassikas, Chairman;
Albert B. Brooke, Jr., Pinkney Walker,
and Rush Moody, Jr.

Optional Procedure for Certificating)
New Producer Sales of Natural Gas) Docket No. R-441

ORDER NO. 455-A

ORDER CLARIFYING ORDER, AND
DENYING APPLICATIONS FOR REHEARING AND STAY

(Issued September 8, 1972)

American Public Gas Association, American Public Power Association and Consumer Federation of America (the Associations) jointly filed on August 10, 1972, an application for rehearing of the Commission's Order No. 455, Optional Procedure for Certificating New Producer Sales of Natural Gas, Docket No. R-441, issued August 3, 1972 (37 F.R. 16188, 8/11/72. Gulf Oil Corporation (Gulf) similarly filed on August 23, 1972, an application for rehearing of said Order and also requested clarification of the Order with respect to warrantly contract sales. On August 29, 1972, twenty-one "Concerned Congressmen" (Congressmen) filed an application for rehearing and motion for stay of the Order. On September 1, Texaco Inc. filed its motion for reconsidera-

tion,[1] and on September 5, 1972, the Public Service Commission for the State of New York, Continental Oil Company, Amoco Production Company, and Phillips Petroleum Co., each filed a petition for rehearing of said Order.[2] We shall discuss the applications for rehearing, motions for clarification, and motions for stay separately, except in such instances as the applicants may have raised the same point.

At the outset, the Associations and "Concerned Congressmen" contend (1) we are without authority to promulgate Order No. 455, and (2) Order No. 455 amounts to deregulation. Our authority to issue Order No. 455 emanates from Congressional delegation of such authority in the Natural Gas Act, as well as the procedural mandates of the Administrative Procedure Act, and the judicial precedents interpreting such statutes. In Order No. 455, we set forth with specificity both our authority to promulgate such a policy statement and the judicial support for the procedures which were adopted (pp. 12-16). In fact, in order to afford the widest public participation possible, we followed the traditional rulemaking procedures—something which we need not have done for a policy statement.

The irrefutable fact is that this Nation is confronted with an energy crisis, and more particularly, a gas shortage. This Commission has used the breadth of its authority to deal with the problems which had arisen over the last decade. This Commission has the flexibility to adapt its policies to changing circumstances[3] and by issuing Order No. 455, we have carried forth our responsibilities as delegated to us by the Congress.

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[1]On September 5, 1972, Amerada-Hess filed a telegraphic joinder in Texaco's petition.

[2]Superior Oil Co. filed a motion for reconsideration on September 7, 1972, and the issues raised in that motion shall be discussed here.

[3]*Permian, infra* at 800, 816 n. 99; *Wisconsin* v. *F.P.C.*, 373 U.S. 294, 309 (1963); *F.P.C.* v. *Natural Gas Pipeline Co.*, 315 U.S. 575, 586 (1942).

The "Concerned Congressmen" and Associations contend we erred in adopting Order No. 455 without a full trial-type hearing. There is no statutory requirement requiring a full evidentiary hearing prior to the issuance of a policy statement.[4] We issued a notice of our proposed rule and solicited written comments from all interested parties. This is the only "hearing" required when an agency proceeds under its informal rulemaking authority.[5] We reiterate that no rates have been prescribed by Order No. 455[6] and that individual hearings will be held on each certificate application so filed at which time any interested party, including petitioners, may intervene and present evidence.[7]

It has been contended that we have deregulated natural gas producers by issuing Order No. 455. The scope of our policy statement is limited to gas produced from a well or wells commenced after April 6, 1972, or gas not previously sold in interstate commerce except under the provisions of Order Nos. 402, 418 or 431. The area rate framework, initiated in 1960, and completed for all major producing areas except Rocky Mountain, is unaffected by Order No. 455. We

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[4]See *U.S.* v. *Allegheny-Ludlum Steel Corp.*, 32 L.Ed. 2d 453, 464-5 (1972); *Siegel* v. *A.E.C.*, 400 F.2d 778 (CADC, 1968); *Pacific Coast European Conference* v. *U.S.*, 350 F.2d 197 (CA 9), cert. denied 382 U.S. 958 (1965); *Long Island RR Co.* v. *U.S.*, 318 F. *Supp.* 490 (E.D.N.Y. 1970); Attorney General's Manual on the Administrative Procedure Act (1947) at p. 78.

[5]Ibid.

[6]APGA argues we have retroactively set rates. Initially, no rates have been prescribed by Order No. 455. Further, rules which affect existing rights have been upheld on numerous occasions. E.g., *WBEN, Inc.* v. *U.S.* 396 F.2d 601, 609, 618, 622 (CA2), cert. denied 393 U.S. 914 (1968); *Air line Pilots Assn., Int.* v. *Quesada*, 276 F.2d 892, 896 (CA2, 1960), cert. denied 366 U.S. 962 (1961).

[7]*P.S.C. of N.Y.* v. *F.P.C.*, CADC, No. 71-1161, March 29, 1972, Slip op. at 13. Compare *Wisconsin* v. *F.P.C.* 292 F.2d 753 (CADC, 1961); *Wisconsin* v. *F.P.C.*, 303 F.2d 380, 387 (CADC, 1961), affirmed 373 U.S. 294 (1963).

have provided an optional procedure for certificating new gas sales. Contrary to the "Concerned Congressmen's" contention, this procedure is not without standards. Certification will be subject to the standards of "just and reasonable" in Section 4 and "present and future public convenience and necessity" of Section 7. We will apply those standards of the Natural Gas Act as interpreted by the courts. In other words, only after a hearing, and Commission findings, subject to Sections 4 and 7, will such a certificate be granted. This is not decontrol. It is the "end result" of our actions which must be judged,[8] and if Order No. 455 assists in alleviating the gas shortage, this Commission is fulfilling its obligations under the Natural Gas Act.

The Associations contend that the optional procedure as promulgated in Section 2.75 of the Commission's General Rules of Practice and Procedure, General Policy and Interpretions, exempt new gas sales from the requirements that the rates and charges therefor be just and reasonable. Such a contention is without merit. Section 2.75 l specifically states that the rates, charges and services to be certificated under the optional procedure shall be just and resonable and required by the present and future public convenience and necessity. In other words, such certification shall conform to the standards of Sections 4 and 7 of the Natural Gas Act.

The second contention of the Associations that the major premise of the optional procedure is to set natural gas rates for new sales solely upon "market conditions" is similarly without merit. This contention is made without regard or recognition of the evidentiary burden imposed upon a seller-applicant by Section 2.75 g, and upon the purchaser by Section 2.75 h. We are not foreclosed from considering "market conditions" any more than we are prohibited from considering "non-cost" factors in an area rate proceeding.

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[8] *F.P.C.* v. *Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944); *Colorado Interstate Gas Co.* v. *F.P.C.*, 324 U.S. 581, 625 (1945).

Permian Basin Area Rate Cases, 390 U.S. 747, 791, 795, 815 (1968); *Austral Oil Co.* v. *F.P.C.*, 428 F.2d 407, 426, 441 (CA5, 1971). Indeed, to ignore such conditions would be to act contrary to the Fifth Circuit's mandate that we must consider market conditions and the industry's capital requirements to meet the consumer needs for reliable and adequate gas service. Id. 428 F.2d at 435, 433-4. We would be derelict in our responsibilities if we did not consider the intrastate market prices and the ability of interstate pipelines to obtain the necessary gas reserves to meet the needs of jurisdictional customers. Order No. 455 represents another step in this Commission's efforts to deal with the gas shortage, and as such, is experimental in the same context as our advance payments policy (See Order No. 455 at pp. 14-15). So too was the initiation of producer area rates experimental in the 1960's and the Supreme Court clearly recognized that we may develop more effective regulatory tools. *Permian, supra* at 772 n. 37, 790, 800. Our action here is, of course, an optional procedure, and while not replacing area rates, we reject the idea that area rates is the *only* method by which producer rates can be determined.

"Concerned Congressmen" indicate our actions will be futile because we erred in not estimating the additional forthcoming new gas reserves. The short answer is that there will be no certificates issued pursuant to Section 2.75 of our Regulations except when the gas so applied for is dedicated to the jurisdictional market. In other words, in each individual certificate hearing, we will know what volumes of gas reserves will be dedicated, prior to the issuance of a certificate.

The Associations contend there is no gas supply shortage. Counsel for APGA's arguments have been rejected by two United States Courts of Appeals[9] and the gas shortage has been recongized by the United States Supreme Court.[10]

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[9] *The People of the State of California* v. *F.P.C.*, CA9, No. 71-1036, July 31, 1972, Slip op. at 20-22; *City of Chicago* v. *F.P.C.*, 458 F.2d 731, 747-9 (CADC, 1971), cert. denied 405 U.S. 1074 (1972).

[10] *F.P.C.* v. *Louisiana Power & Light Co.*, No. 71-1016, S.Ct., June 7, 1972, Slip op. at 4.

Counsel for the Associations would have this Commission ignore the curtailments of firm gas customers by seven major interstate pipelines have now filed curtailment plans. Firm requirement deficiencies during the 1972-1973 heating season are expected to be even more severe.[11] In other words, new customers are being denied gas service and the service to existing customers is being reduced. The salient fact is that there is a shortage in deliverable gas reserves contrary to the national interest.

Counsel for Association contend we have "denied the consumers of a right to a hearing on the record of the facts relating to the shortage issue." Counsel, representing the American Public Gas Association, advanced similar arguments in the Rocky Mountain proceeding, involving initial rates and has sought court review and in the Hugoton-Anadarko area rate case.[12] In the latter case, the Ninth Circuit, in affirming the Commission's orders in full, rejected the Association's arguments. *People of State of California, supra.* In each of these proceedings, among others, counsel had a "right to a hearing on the record of the facts relating to the shortage issue." Other parties representing consumer interests and the Commission staff also participated in those proceedings. In each case, based upon a full evidentiary record, the Commission determined there was a gas shortage. While we will continue to provide a forum for counsel, inasmuch as the disappointed litigant has not submitted any evidence in this proceeding through written comments, we will reject his unsupported allegations. However, in any certificate proceeding, counsel may, of course, submit such evidence at a public hearing, including that related to the "shortage issue."[13]

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[11]Date a filed with the FPC by 15 pipelines indicate projected deficiencies of 1 trillion cubic feet or almost 10 percent of those pipelines' annual gas sales.

[12]Counsel advanced the same arguments on behalf of the Municipal Distributors Group in the Southern Louisiana area rate proceeding which is presently before the Fifth Circuit for review.

[13]See *City of Chicago, supra,* at 749.

However, in the interim, this Commission will rely, for purposes of determining the gas consumer needs of this Nation, on the *fact* that those needs are not being met. We will continue to rely on evidence of pipeline curtailments, investment in alternate energy sources and supplemental gas supplies, reports of shortages by state commissions, federal resource agencies, in addition to published data concerning exploratory and developmental well activity, the gas reserves of the interstate pipelines as reported to us on Form 15, the Potential Gas Committee, the Future Requirements Committee, Staff Report No. 2 and other relevant data.

"Concerned Congressmen" and Associations contend our action here violates Price Commission Regulations because the price increases are inflationary. The fact is that there are no price increases contemplated under Docket No. R-441 for gas already dedicated to the interstate market, to which an "initial price" will be determined as a condition to the certificate. That "initial price" will represent a just and reasonable determination of the lowest reasonable rate consistent with adequate service. An important policy consideration which we cannot ignore is that because of the gas supply-demand imbalance, unsatisfied gas demands are transferred to higher-priced alternate fuels, which both increases demand and prices for those fuels and in other energy markets, to the detriment of consumers. A continuation of the gas shortfall will likewise serve as a deterrent to economic recovery. Thus, our Order No. 455 balances the objectives of the Natural Gas Act and the Economic Stabilization Act of 1971.

"Concerned Congressmen" urge this Commission to recommend accelerated leasing of federal domain lands to the Department of Interior. As a matter of policy, we have urged, both by letters and other requests, for increased lease sales on federal lands in order to obtain the maximum efficient development of our domestic resource base. This Commission policy recognizes that the development of such resources is responsive to factors other than wellhead prices established by the Federal Power Commission, including *inter alia*, leasing policies on federal domain lands, tax policies, the relative attraction between domestic and foreign investments, and the industry's technological level concerning offshore operations.

The Associations assert that the provision in Section 2.75e for certification with or without pregranted abandonment is contrary to Section 7(b) of the Act. Suffice to say that Section 7(b) requires, *inter alia*, that no natural gas company may abandon jurisdictional service without having first obtained the lawful permission and approval of the Commission that the present or future public convenience and necessity permits such abandonment. Certainly, when an application for pregranted abandonment is before it for determination as to its certification, the Commission may make the necessary findings required by Section 7(b) of the Act.

The Associations alleged that the Commission erred in allowing pipeline-production, including affiliated companies, to utilize the optional procedure because they state "no arms length negotiation over prices exists in such situations." We have not opened Section 2.75 procedures to pipeline production, and as we stated in Order No. 455 (Mimeo. p. 21, par. 63) we will, "absent a showing of special circumstance, accept as conclusive the cost findings embodied in our area rate decisions, as such may be supplemented from time to time by appropriate Commission order." Thus, we can only reiterate that transactions between pipelines and affiliates, or subsidiary off-system sales, will be examined by us to assure that such transactions and "the proposed rates are reasonable and in the public interest." In any event, the fact of whether or not the transaction is conducted at "arms-length" is but one of many to be considered by us in making a just and reasonable determination.

In its request for clarification and reharing, Gulf contends that exclusion of warranty contract sales from the optional certificate procedure of Order No. 455 is unduly discriminatory because, by its terms, it does not apply to such sales from wells commenced after April 6, 1972. The Commission reaffirms its intention to exclude warranty contract sales from the provisions of Order No. 455 because such contracts contemplate additional drilling, if necessary, in fulfillment of the volumetric warranty. Drilling under warranty contracts does not in itself result in increased gas supplies to the interstate market, and, therefore, it follows that sales under

such existing contracts should not be eligible for the optional procedures of Order No. 455.

However, Gulf submits that a producer-seller should have the opportunity to amend its contract to be applicable to gas producer leases acquired, and wells drilled thereon after April 6, 1972, and to be able to demonstrate to the Commission that prices incurred in such acquisitions and drilling are in the public interest. That issue is pending for decision in another proceeding to which Gulf is a party, and we will not rule on that issue here.

The petition for rehearing of the Public Service Commission of the State of New York reiterates the contention made in its comments, filed in response to the notice herein, that we should exclude short-term contracts from certification under the optional procedure. New York in its petition for rehearing sets forth no facts nor does it advance any argument that we did not have before us when we determined not to condition Section 2.75 e so as to exclude such short term contracts. Reconsideration of the matter has not caused us to change our determination. The duration of the contract will be one factor in our determination in the individual certificate proceeding.

Continental suggests that the Commission erred in failing to provide expressly that denial of an application by the Commission, or rejection of a certificate under the optional procedure by a seller, would vitiate and nullify all waivers made by the seller in connection with the application. Had we intended the waiver requirements of 2.75 to apply irrespective of whether certificates ever became effective under 2.75, we would have so stated. It is our intention that the waivers required by Section 2.75m are effective only in the event that the 2.75 application containing the waivers is approved by the Commission and the certificate thereunder accepted by the seller/applicant. If the Commission denies the application, or prescribes conditions which are unacceptable to the seller/applicant, the waivers which were made a part of the application are not binding upon the seller/applicant.

Continental and Texaco request clarification with respect to paragraph b(4) of Section 2.75, asking whether it is necessary for a seller/applicant to show that it has discharged its refund obligations under all prior orders or opinions of this Commission in order to be eligible for presentation of an application. We did not so intend. We require only that a seller/applicant show, with respect to the geographical pricing area in which the prospective seller would commit the gas under the optional procedure, that he has discharged, or is prepared by plan or program to discharge, refund obligations with respect to that geographic area. Thus, if a seller/applicant should owe refunds in Southern Louisiana but not owe refunds in the Texas Gulf Coast Area, the seller/applicant would be able to utilize 2.75 procedures for Texas Gulf Coast Area gas without regard to the status of its refund obligations in Southern Louisiana.

We have also been asked to clarify whether or not contract escalations approved by the Commission in a Section 2.75 proceeding would be self-operative or whether such would necessarily be subject to rate change filings under Section 4(e) of the Natural Gas Act. We believe that this inquiry is answered by *Episcopal Theological Seminary of the Southwest* v. *F.P.C.*, 269 F.2d 228 (CADC), cert. denied *sub nom.*, *Pan American Petroleum Corp.* v. *F.P.C.*, 361 U.S. 895 (1959), wherein it was held that *no* rate change could become effective without a 4(e) filing. This is not to say, however, that the Commission recedes from the basic position expressed in Order No. 455 that it intends to grant sanctity of contract to the full extent that the Commission can, absent amendment of the Natural Gas Act by Congress. It is our intention to consider applications under Section 2.75 and make a one time determination of the public convenience and necessity aspects of the certificate application and the justness and reasonableness of the rates therein proposed, both as to initial rates and as to definite escalations which might be embodied in the contract. For future definite escalations to become effective without a 4(e) filing will require amendment of the Natural Gas Act, through legislation such as that now pending before Congress.

It is most forcefully argued by Continental, Texaco, Phillips and Amoco that we have erred in outlawing certain types of escalation clauses in Section 2.75f and that the prohibitions of subsection f will operate as a disincentive to long-term commitment of natural gas to the interstate market. We are particularly urged to permit the inclusion of so-called "FPC clauses" or "area rate clauses" in contracts tendered for certification under Section 2.75.

If we did not intend to afford sanctity of contract to the fullest extent available to this Commission, we would be inclined toward sympathy with the producers' view. However, we think it inappropriate for us to sanctify a contract in the sense of guaranteeing that the price will not go down but deny the reciprocal sanctity that a certificated contract price will not rise.

We are of the firm opinion that the optional procedure should stand on its own as a means of producer rate regulation, and represent a true option to those buyers and sellers who choose the optional procedure over regulation under the area rate structure. To accept the requests of these applicants would permit them the benefits of the higher price obtainable under either system, a procedure which we decline to adopt.

The Commission further finds and orders that:

(1) Except for the clarifications in the order as herein provided, the applications for rehearing, motions for reconsideration, and motions for stay, are denied, inasmuch as no new facts or legal authorities have been presented which would require further modification of Order No. 455.

(2) Section 2.75b.4. is hereby amended to read as follows:

The seller under such contract establishes that he has discharged, or is prepared by plan or program to discharge, refund obligations in the geographical pricing area in which the seller would commit gas under such contract, prescribed by prior orders or opinion of this Commission. It is provided, however,

that any such seller may make the showing here required without prejudice to his claim in any case now pending on judicial review that such obligations were unlawfully imposed by the Commission.

By the Commission.

Kenneth F. Plumb,
Secretary

(S E A L)